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QUESTIONS AND ANSWERS ABOUT LENDERS AND THE REFORM ACT

Adapted from the *Watermark,* a newsletter published by FEMA

Of great importance to lenders is the increased lender compliance, signed into law in the National Flood Insurance Reform Act. Below are some questions and answers about how the act impacts lenders, secondary market purchasers, and their compliance.

***Q*. What will be the impact on lenders' compliance with flood insurance requirements?**
***A*.** Very positive! The new provisions not only strengthen those efforts, they provide additional tools to lenders to help them comply with the law. After lenders have had a chance to review and adapt to the new requirements, they are more likely to proceed with full compliance. The result should be a far greater number of flood insurance policies being purchased, thereby protecting a greater number of properties.

***Q*. Can the cost of flood insurance be escrowed by lenders?**
***A*.** Yes. As a matter of fact, if a lender is already escrowing for other insurance-related purposes, it is required to do so for flood insurance costs as well. This requirement will help ensure that flood insurance is purchased and maintained, similar to the way lenders who escrow are able to handle other property insurance.

***Q*. Will there be any exceptions for loans having to meet flood insurance requirements?**
***A*.** Yes. Small loans of $5,000 or less and for a term of less than one year are exempt from flood insurance requirements.

***Q*. Are all lenders covered under the new law?**
***A*.** No. Only those lenders that are under the jurisdiction of the federal regulatory agencies, those that provide loans such as Fannie Mae, Freddie Mac, and Ginnie Mae through federal agencies, are covered by the new law. Lenders such as mortgage banks and commercial finance companies that do not sell their loans to a GSE are not covered by the law.

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Q. **Will lenders be able to require flood insurance at any time during the term of a loan?**

A. Yes. If a lender discovers, at any time during the term of a loan, that the building is located in a special flood hazard area, the lender *must* notify the borrower that flood insurance is required.

Q. **May lenders purchase flood coverage on behalf of the borrower?**

A. Yes. If a lender notifies a borrower of the need for flood insurance, and the borrower refuses to respond, the lender *must* purchase the coverage on behalf of the borrower and *may* pass the costs of obtaining the coverage on to the borrower.

Q. **Will there be any penalties for noncompliance with the law?**

A. Yes. Currently, the penalties of the Federal Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) apply to such violations. The new law adds additional financial penalties that will apply to patterns of such violations.

Q. **Must lenders provide notification of services and, if so, why?**

A. Yes. The lender must notify FEMA of the services of the loan, both during the term of the loan and within 45 days if the servicer of the loan changes. This is so that FEMA and the flood insurance companies that write the flood insurance policies can send policy renewal and/or cancellation notices to the appropriate lender/servicer on the loan for the insured property.

Q. What are the major provisions of the bill?

A. The major provisions of the bill are as follows:

- Improve compliance with the mandatory purchase requirements of the NFIP by lenders and secondary market purchasers
- Codify the current Community Rating System
- Create a mitigation assistance grant program
- Create a new mitigation insurance benefit
- Create a task force to study compliance with the mandatory purchase requirements
- Create a task force to study the natural and beneficial functions of floodplains
- Increase coverage limits
- Study the economic impact of mapping erosion hazard areas
- Study the economic effects of charging actuarially-based premium rates for Pre-FIRM structures
- Increase the waiting period for flood insurance policies to 30 days
- Prohibit federal disaster assistance in certain cases where flood insurance has not been maintained

Q. **The stated purpose of the National Flood Insurance Reform Act is to improve the financial condition of the NFIP. How will that be accomplished?**

A. The act is expected to improve the financial condition of the NFIP and reduce the federal expenditures for federal disaster assistance to flood-damaged properties through:

- <u>Increased lender compliance</u>, which will help increase the number of flood insurance policies that are placed and maintained, thereby protecting more people throughout the country and reducing the need for federal disaster assistance

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- Mitigation assistance grants, which will provide assistance for states and communities to mitigate before a flood damages or destroys homes and businesses, rather than after a flood has already caused damage
- Mitigation insurance, which will give people the financial ability to rebuild their repeatedly flooded or substantially damaged homes and businesses to code, thereby reducing the cost and amount of future flood damage

Q. **What is the Mitigation Assistance Program?**

A. The reform act states that FEMA will provide financial assistance to states and communities, using money made available from the National Flood Mitigation Fund for planning and carrying out activities designed to reduce the risk of flood damage.

Q. **What is mitigation insurance?**

A. Mitigation insurance gives people additional financial ability to rebuild their flood-damaged homes or businesses according to their community's flood-proofing and mitigation regulations.

Q. **How much will mitigation insurance cost?**

A. A maximum charge of $75 will be added to flood insurance premiums for the mitigation insurance. However, the cost may be as little as $3 to $6. The cost will be based on the risk that the structure will be damaged and a claim will be made. For instance, an older building that does not meet NFIP standards will cost more than a newer one that has been elevated in compliance with NFIP standards.

Q. **Won't the new mitigation insurance encourage people to live in harm's way?**

A. As stated above, the purpose of the mitigation insurance is to give people additional financial ability to rebuild their flood-damaged homes or businesses according to their comunity's regulations. These people are already in harm's way. When one of these homes or businesses is substantially damaged or repeatedly flooded, the owner will be able to afford to recover in a way that reduces future flood damage instead of rebuilding incorrectly and without reducing the risk. Repeatedly damaged properties represent less than 3 percent of the properties insured, but account for approximately 40 percent of the losses paid. Mitigation insurance will assist property owners who build in compliance with NFIP requirements and increase the number of buildings that are built to reduce flood damage. This will result in fewer and less expensive claims.

Q. **What is the purpose of the Flood Insurance Interagency Task Force?**

A. The Flood Insurance Interagency Task Force was developed to accomplish the following:

- Recommendations of standardized enforcement procedures
- Study of compliance assistance for lenders
- Study of compliance model for lenders
- Recommendations for enforcement procedures and compliance
- Study of flood zone determination fees

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Q. **What is the purpose of the Task Force on Natural and Beneficial Functions of the Floodplain?**

A. The Task Force on Natural and Beneficial Functions of the Floodplain was developed to:

- Identify the natural and beneficial functions of the floodplain that reduce flood-related losses
- Develop recommendations on how to reduce flood losses by protecting the natural and beneficial functions of the floodplain

Q. **What will be covered in the study of economic effects of charging actuarially-based premium rates for Pre-FIRM structures?**

A. The reform act calls for a study of the economic effects of increasing premium rates for flood insurance coverage made available under the NFIP for Pre-FIRM structures to the full actuarial-risk-based premium rate. The study will include the following:

- Determine each area that would be subject to such increased premium rates
- For each area determine:
  - * The amount by which premium rates would be increased
  - * The number and types of properties affected
  - * The number and types of properties where existing flood insurance is likely to be cancelled if premiums are increased
  - * The effects that increased premium rates would have on land values and property taxes
  - * Any other effects that increased premium rates would have on the economy and homeowners

Q. **How is the flood insurance waiting period affected?**

A. There will be a 30-day waiting period before new and modified flood insurance policies go into effect.

Q. **Are there cases when the 30-day waiting period is not applicable?**

A. Yes. The 30-day waiting period does not apply in the following situations:

- Initial purchase of flood insurance when the purchase is in connection with making, increasing, extending, or renewing a loan
- Initial purchase of flood insurance due to a revision or updating of floodplain areas or flood-risk zones if that purchase occurs during the one-year period beginning with the publication of the notice of revision or update

Q. **How will the longer waiting period affect the NFIP?**

A. The waiting period has been extended from 5 days to 30 days, as stated above. There have been instances, such as the 1993 Midwest Flood, where people knew a flood was coming and bought flood insurance in enough time to be eligible for a claim payment for the flood damage they suffered. The new waiting period means that people who wait to buy a flood insurance policy until a flood is coming will not likely benefit from the coverage in connection with that flood. It is important to note that a loss in progress has never been covered, so if a flood insurance policy were purchased and flood waters were touching the newly covered home or business before the 5-day waiting period was over, a flood insurance claim payment would not have been made. Though this 30-day waiting period will affect last-minute purchases, it should prompt people to prepare for a flood by buying flood insurance in advance and maintaining the policy.

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NEW STANDARD HAZARD DETERMINATION FORM (Flood Hazards)

The National Flood Insurance Reform Act of 1994 requires all lenders to use a nationwide Standard Hazard Determination Form developed by the Federal Emergency Management Agency (FEMA). The form must be used for any loan made, increased, extended, renewed, or purchased by a federally regulated lending institution and secured by improved real estate or a mobile home. This form meets the requirements of Section 1365 of the National Flood Insurance Act of 1968, as amended by the National Flood Insurance Reform Act of 1994, P.L. 103-325. Exception: This form is not required for loans with an original outstanding minimal balance (less land value) of $5,000 or less and a repayment term of one year or less.

The hazard determination form must be completed by the lender itself, who guarantees the accuracy of the determination. The determination will be valid for a period of five years. Consequently, local floodplain administrators and the state floodplain management program will no longer make determinations for lenders.

The use of this form became mandatory January 1, 1996.

MONTANA DISCLOSURE PROVISION

The *Administrative Rules of Montana* under Local Regulations Requirement Section 36.15.204.2g contain the following statement.

> *Any land use regulations and administrative and enforcement procedures adopted to comply with the Montana Floodplain and Floodway Management Act and the rules (ARMs) must include . . . a disclosure provision requiring all property owners with property in a designated floodplain or floodway, or their agents, to notify potential buyers that such property is located within the designated floodplain or floodway and is subject to regulation.*

The provision is to protect buyers of property located in a delineated 100-year floodplain within communities that have adopted the state regulations for floodplain development. In a number of cases, the seller has not disclosed that the property is within the designated floodplain, and the new owners have been unable to develop that property due to certain regulations for development and/or septic systems. This provision allows the new owner a form of recourse against the previous owner or agent.

Approximately 70 percent of the Montana communities enrolled in the NFIP have adopted the state floodplain development requirements that contain the disclosure provision. Be sure of which regulation your community has adopted, and disclose whether your property is within a delineated 100-year floodplain. If you are unaware whether your property is in a floodplain, contact your local floodplain administrator. *DON'T PASS THE MUCK ON TO SOMEONE ELSE!!*

Q. **When will the mitigation insurance, new coverage limits, and increased waiting period take effect?**

A. The mitigation insurance, coverage limits, and waiting period, as well as some other provisions, have to be changed by regulation. FIA plans to have the coverage limits and waiting period become effective on March 1, 1996. The mitigation insurance will become effective on a date to be determined. FIA will alert WYP companies, insurance agents, lenders, and others when the changes take place.

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